



Oridion Systems Ltd.

CEO Letter to Shareholders

May 2007



When every breath counts



Oridion®



Dear Shareholder,

I am pleased to report that, notwithstanding the temporary cessation of deliveries to the US market by one of our most important OEM partners, Medtronic Physio-Control, Oridion had a strong first quarter, recording its 25th consecutive quarter-on-quarter growth in revenues and improvement in operating results. Revenues grew by 13 % to USD 8.4 million and operating income from continuing operations was USD 0.7 million. Oridion's financial results and other significant events and achievements for the quarter are provided in this report.

Financial results in Q1, 2007

Revenues

Company revenues for the first quarter of 2007 increased by 13% to USD 8.4 million compared to USD 7.5 million for the first quarter of 2006. Revenue growth is being driven by a general increase in demand from the market for Oridion capnography devices supplied by our leading OEM partners and an increase in usage of our patient-interface consumables. This continues to be primarily a consequence of increased awareness of the need to improve patient safety in hospital and pre-hospital settings and the related continuing stream of new recommendations by important professional medical organizations for the use of capnography to improve standards of patient safety and patient care. We are pleased that the programs launched in the last couple of years for sustaining high consumables growth – the Oridion Distribution Network and the launch into new, high-potential hospital environments and applications, e.g., procedural sedation and pain management – continue to develop very satisfactorily. Growth in revenues would, of course, have been higher still if not for Physio-Control's FDA-related voluntary cessation of shipments of their defibrillators to the US market. Sales of Oridion consumables to Physio-Control's large installed base of Oridion Microstream® modules were unaffected.

Results overview for the first quarter of 2007

U.S. dollars in thousands	Three months ended March 31,	
	<u>2007</u>	<u>2006</u>
Revenues	8,409	7,456
Gross Profit	4,412	3,844
<i>Gross Margin</i>	<i>52.5%</i>	<i>51.6%</i>
Operating Expenses	3,756	3,559
Operating Income from continuing operations	656	285
Net Income from continuing operations	679	292
Net Loss from discontinued operations	-	(502)
Net Income / (Loss)	679	(210)

Gross Profit

The Company's gross profit for the first quarter of 2007 increased to USD 4.4 million compared to USD 3.8 million for the same period last year, and the current gross margin increased to 52.5% compared to 51.6% for the same period last year. This increase is due mainly to reducing the cost of the new generation Minimedico2 board, and the increase of consumables sales as a percent of total sales.

Operating Expenses

Total operating expenses were USD 3.8 million for the first quarter of 2007 compared to USD 3.6 million for the first quarter of 2006, an increase of 6%. The primary reasons are increased investment in marketing, education materials and customer training and in R&D programs for new products. The Company continues to increase efficiencies overall in order to remain cost effective.

Research and Development

R&D expenses increased to USD 0.8 million for the first quarter of 2007 compared to USD 0.7 million for the first quarter of 2006. Current R&D expenses include investments in enhancing the proprietary technology contained in the Company's consumable products, and in products that will expand the use of capnography in the new clinical settings in which CO₂ monitoring has in the past been very limited, for example, gastroenterology, pain management and cardiac catheterization.

Sales and Marketing

Sales and marketing expenses for the first quarter of 2007 increased to USD 2.3 million compared to USD 2.2 million for the first quarter of 2006. Current activities include the continuing management of an intensive program of clinical studies of Oridion's Capnography, aimed at demonstrating the unparalleled benefits and clinical value offered by the Company's CO₂ monitoring and diagnostic products. These expenses also include support activities for Oridion's OEM and ODN partners in their educational and marketing efforts, training sessions for the growing number of customers that choose to improve the standard of medical care with Microstream® capnography, and additional personnel to help implement the new programs. These efforts continue to result in the constantly increasing usage rate of Oridion's products by a wide range of segments of the medical community.

General and Administration

General and Administration expenses for the first quarter of 2007 remained steady at USD 0.7 million compared to the first quarter of 2006.

Operating and Net Results

Oridion earned operating income from continuing operations of USD 0.7 million for the first quarter of 2007 compared to operating income of USD 0.3 million for the same period last year.

Net income from continuing operations was USD 0.7 million for the first quarter of 2007 compared to a net income of USD 0.3 million for the first quarter of 2006.

Net income for the Group was USD 0.7 million for the first quarter of 2007 compared to a net loss of USD 0.2 million for the first quarter of 2006 (which included a net loss from the discontinued Breath Testing activities).

Cash Position and Cash Flow

Cash and cash equivalents, short-term deposits and marketable securities increased to USD 7.0 million as at March 31, 2007 compared to USD 6.4 million as at December 31 2006.

Net cash provided by operating activities was USD 0.3 million for the first quarter of 2007, the main reasons being a net profit, a decrease in trade receivables and inventory against a decrease in trade payables. Net cash used in investing activities was USD 2.2 million mainly due to the investment in marketable securities and short-term deposits. Net cash provided by financing activities amounted to USD 0.5 million owing to proceeds from the exercise of employee stock options.

Achievements and Events in 2007

The following were achieved thus far in 2007:

- Oridion signed an OEM agreement with Welch Allyn, a leading manufacturer of patient monitoring devices, to integrate Oridion's capnography boards and consumables into their monitoring solutions. Welch Allyn has a strong market position in transport monitoring, portable bedside monitoring, centralized monitoring, and military field and hospital applications. In Welch Allyn's press release, they declared Oridion's Microstream® to be the "world's leading capnography technology".
- Oridion reached a favourable settlement of its patent infringement lawsuits against GE Medical Systems Information Technologies GmbH, Zoll Medical Corporation, Zoll Medical Deutschland GmbH and Respironics Deutschland GmbH & Co KG ("the defendants"). According to the agreement, the Defendants will cease and desist all activities in Germany, Italy and the United Kingdom concerning the selling of the CapnoFlex LF CO2 consumable and will cancel all appeals and other actions by the Defendants. The financial aspects of the agreement addressed the costs incurred by Oridion to pursue the legal actions. Oridion is also pleased that, to our knowledge, the infringing products have been withdrawn not only from the markets cited in the Agreement but from all markets served by these companies.
- A number of major internal initiatives were undertaken in order to respond effectively to the Company's rapid growth. Specifically, the implementation of a new Company-wide ERP system is nearing completion, which should help strengthen Oridion's management and control processes; and Six Sigma techniques have been introduced into various Oridion processes in order to further upgrade such areas as product quality assurance and product development effectiveness.

Outlook

Our first quarter revenue growth reflects the positive developments that we experience in our markets. In fact, growth was somewhat stronger than we expected and we believe that quarter two will be more in line with our annual guidance growth rate (5%-7%). In January 2007, Medtronic Physio-Control announced an FDA-related voluntary cessation of shipments to the US market, which resulted in an immediate stop in their orders to Oridion of modules that are incorporated into the Physio-Control products. Consumable sales were unaffected. As a result of communications this past week with Physio-Control, we anticipate a resumption of orders in the third quarter of 2007. Although it currently remains uncertain as to when orders will

actually resume and when they will reach prior levels, we are clearly pleased with this development.

This, in addition to continued positive developments in our marketplace, encourages us to believe that Oridion's performance for the remainder of 2007 will reach our guidance levels. Beyond 2007, we are particularly optimistic. It is our expectation that because of the strong growth drivers in our markets and our channels, and because of the expected impact of new OEM partnerships, Oridion's level of growth achieved in recent years is sustainable for the foreseeable future.

We again thank our dedicated team of employees, who diligently strive to provide medical technologies and products of unparalleled capabilities and quality, and which make substantive improvements to patient safety. We also continue to thank our shareholders and partners for their ongoing support and belief in Oridion. We strive to reward that support with increased shareholder value as Oridion strives to constantly improve its financial performance. After many years of intensive growth-oriented investments, our performance going forward is now based on a solid, profitable foundation. We look forward to sharing our future successes with you.

Sincerely,



Alan Adler
Chairman of the Board of Directors and CEO

Jerusalem, Israel

May 14, 2007

CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands

	March 31, 2007	December 31, 2006
	Unaudited	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	4,847	6,326
Short-term deposits	987	75
Marketable securities	1,175	-
Trade receivables	5,710	6,543
Other accounts receivable and prepaid expenses	839	804
Inventories	3,836	4,248
<u>Total current assets</u>	17,394	17,996
SEVERANCE PAY FUND	1,553	1,413
PROPERTY AND EQUIPMENT, NET	2,735	2,778
<u>Total assets</u>	21,682	22,187
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	2,821	4,231
Other accounts payable and accrued expenses	2,902	3,357
<u>Total current liabilities</u>	5,723	7,588
ACCRUED SEVERANCE PAY	2,153	2,025
SHAREHOLDERS' EQUITY:		
Share capital:		
Ordinary shares of NIS 0.01 par value -		
Authorized: 20,000,000 shares at March 31, 2007 and December 31, 2006; Issued and outstanding: 12,094,286 shares at March 31, 2007 and 11,809,858 shares at December 31, 2006		
	28	27
Additional paid-in capital	76,998	76,446
Accumulated deficit	(63,220)	(63,899)
<u>Total shareholders' equity</u>	13,806	12,574
<u>Total liabilities and shareholders' equity</u>	21,682	22,187

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS
U.S. dollars in thousands (except share and per share data)

	Three months ended		Year ended
	March 31,		December 31,
	2007	2006	2006
	Unaudited		
Revenues	8,409	7,456	34,637
Cost of revenues	3,997	3,612	16,255
Gross profit	4,412	3,844	18,382
Operating expenses:			
Research and development, net	761	704	2,734
Selling and marketing	2,338	2,156	9,220
General and administrative	657	699	2,607
<u>Total operating expenses</u>	<u>3,756</u>	<u>3,559</u>	<u>14,561</u>
Operating income	656	285	3,821
Financial income (expenses), net	23	7	(125)
Net income from continuing operations	679	292	3,696
Net loss from discontinued operations	-	(502)	(502)
Net income (loss)	<u>679</u>	<u>(210)</u>	<u>3,194</u>
Basic earnings per share from continuing operations	0.06	0.02	0.32
Basic loss per share from discontinued operations	-	(0.04)	(0.04)
Total basic net earnings (loss) per Ordinary share	<u>0.06</u>	<u>(0.02)</u>	<u>0.28</u>
Diluted earnings per share from continuing operations	0.05	0.02	0.29
Diluted net loss per share from discontinued operations	-	(0.04)	(0.04)
Total diluted net earnings (loss) per Ordinary share	<u>0.05</u>	<u>(0.02)</u>	<u>0.25</u>
Weighted average number of shares used for computing basic net earnings (loss) per share	11,914,050	11,414,572	11,592,122
Weighted average number of shares used for computing diluted net earnings (loss) per share	13,131,019	12,798,022	12,788,619

The accompanying notes are an integral part of the consolidated financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
U.S. dollars in thousands

	<u>Share capital</u>	<u>Additional paid-in capital</u>	<u>Accumulated deficit</u>	<u>Total shareholders' equity</u>
Balance as of January 1, 2006	26	75,134	(67,093)	8,067
Exercise of options, net	1	714	-	715
Exercise of warrants	*) -	-	-	*) -
Stock-based compensation	-	598	-	598
Net income	-	-	3,194	3,194
Balance as of December 31, 2006	27	76,446	(63,899)	12,574
Exercise of options, net	1	464	-	465
Stock-based compensation	-	88	-	88
Net income	-	-	679	679
Balance as of March 31, 2007 (unaudited)	<u>28</u>	<u>76,998</u>	<u>(63,220)</u>	<u>13,806</u>

*) Represents an amount lower than \$ 1.

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Three months ended		Year ended
	March 31,		December 31,
	2007	2006	2006
	Unaudited		
Cash flows from operating activities:			
Net income (loss)	679	(210)	3,194
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Loss from discontinued operations	-	502	502
Depreciation	196	169	704
Amortization of deferred stock compensation	88	130	558
Amortization of deferred stock compensation related to warrants issued to credit providers and others	-	22	32
Accrued severance pay	(12)	(5)	(79)
Decrease (increase) in trade receivables	833	(511)	(1,628)
Increase in other accounts receivable and prepaid expenses	(28)	(80)	(247)
Decrease (increase) in inventories	412	(735)	(1,706)
Increase (decrease) in trade payables	(1,410)	138	914
Increase (decrease) in other accounts payable and accrued expenses	(455)	(156)	394
Net cash provided by (used in) operating activities from continuing segment	303	(736)	2,638
Net cash used in operating activities from discontinued segment	-	(435)	(579)
Net cash provided by (used in) operating activities	303	(1,171)	2,059
Cash flows from investing activities:			
Investment in marketable securities	(1,175)	-	-
Purchase of property and equipment	(153)	(154)	(618)
Proceeds from (investment in) short-term bank deposits, net	(912)	-	2,542
Net cash provided by (used in) investing activities from continuing operations	(2,240)	(154)	1,924
Net cash provided by investing activities from discontinued operations	-	-	10
Net cash provided by (used in) investing activities	(2,240)	(154)	1,934
Cash flows from financing activities:			
Short-term bank credit, net	-	323	-
Repayment of long-term loan	-	-	(2,500)
Proceeds from exercise of options and issuance of shares, net	458	224	694
Net cash provided by (used in) financing activities	458	547	(1,806)
Increase (decrease) in cash and cash equivalents	(1,479)	(778)	2,187
Cash and cash equivalents at the beginning of the period	6,326	4,139	4,139
Cash and cash equivalents at the end of the period	4,847	3,361	6,326

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
U.S. dollars in thousands

	Three months ended March 31,		Year ended December 31,
	2007	2006	2006
	Unaudited		
<u>(a) Significant non-cash transactions:</u>			
Other accounts receivable in respect of exercise of options	7	45	21
<u>(b) Supplemental disclosure of cash flow information:</u>			
Cash paid during the period for:			
Interest	-	43	143

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL

Oridion Systems Ltd. ("the Company") is a holding company, which wholly-owns Oridion Medical 1987 Ltd. and all of its subsidiaries. The Company is a medical technology company based in Jerusalem, Israel and Needham, Massachusetts, U.S.A. The Company employs its patented Microstream® technology in the development, manufacturing and marketing of products used in its business - Capnography - the non-invasive measurement of carbon dioxide contained in the exhaled breath to determine the adequacy of respiration.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the annual financial statements of the Company as of December 31, 2006, are applied consistently in these financial statements except as follows:

a. Investments in marketable securities:

The Company accounts for investments in marketable securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

Management determines the appropriate classification of its investments at the time of purchase and reevaluates such determinations at each balance sheet date.

The Company classifies all of its securities as available for sale. Available for sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in "accumulated other comprehensive income (loss)" in shareholders' equity. Realized gains and losses on sale of investments are included in earnings and are derived using the specific identification method for determining the cost of securities.

For the three months ended March 31, 2007 unrealized gains or losses on marketable securities were immaterial.

b. Change in Method of Accounting for Inventory Valuation:

On January 1, 2007, the Company elected to change its method of valuing its inventory to the first in first out ("FIFO") method, whereas in all prior years inventory was valued using the average cost method. The new method of accounting for inventory was adopted in connection with the introduction of the new Enterprise Resource Program into the Company. The Company believes that the FIFO method is preferable, since it will allow the Company to better manage its accounting for inventory costs.

Comparative financial statements for prior years have not been retrospectively adjusted due to immateriality.

NOTE 3:- UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2007, are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

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Next quarterly report

August 20, 2007

Announcement of 2nd quarter 2007 results

